

Report
of the
Examination of
New Hope Mutual Insurance Company
Iola, Wisconsin
As of December 31, 2001

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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May 17, 2002

Honorable Connie L. O'Connell
Commissioner of Insurance
State of Wisconsin
121 East Wilson Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2001, of the affairs and financial condition of

NEW HOPE MUTUAL INSURANCE COMPANY
Iola, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The last examination of this company was made in 1997 as of December 31, 1996. The current examination covered the intervening time period ending December 31, 2001, and included a review of such subsequent transactions deemed essential to complete this examination.

The Summary of Examination Results contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company on January 28, 1887, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the New Hope Norwegian Mutual Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there was one amendment to the articles of incorporation and no amendments to the bylaws. The articles of incorporation were amended to expand the company's business territory to include Shawano, Waushara and Wood counties.

A review of the certificate of authority revealed that the company is currently licensed to write business in the following counties:

Marathon, Portage, Shawano, Waupaca, Waushara, Wood

New Hope is currently licensed to write property, including windstorm and hail, and nonproperty insurance.

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for terms of both one year and six months with premiums payable on the advance premium basis. Policy fees charged policyholders are retained by the company.

Business of the company is acquired through three agents, two of whom are directors of the company. Agents are presently compensated for their services as follows:

Type of Policy	Compensation	
	New	Renewal
Fire and Extended Coverage	25%	15%
Homeowners	25%	15%
Liability	15%	15%

Agents receive the “new” commission rate of 25% for all new policies, and also for renewals with a signed application, which is assumed to indicate that the agent performed a reinspection of the risk. The decision of which policyholders to select for a signed application (and reinspection) is at the agent’s discretion. This practice is discussed further in the “Management and Control” section of this report.

Agents have full authority to adjust losses. Adjusters receive \$20 for the initial contact and \$30 for each loss adjusted plus \$.365 per mile for travel allowance.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of six members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Richard Anderson *	Agent	Amherst, WI	2004
Donald Peterson	Farmer	Scandinavia, WI	2004
John Haroldson *	Agent	Rosholt, WI	2003
Alyce Kolden	Retired Office Manager	Iola, WI	2003
James Isherwood	Farmer	Plover, WI	2005
Dawn Johnson	Office Manager	Iola, WI	2005

Directors who are also agents are identified with an asterisk.

Members of the board currently receive \$50 for each full day meeting attended and \$35 for each ½ day meeting attended and \$.365 per mile for travel expenses.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified.

Officers serving at the present time are as follows:

Name	Office	Annual Salary
Richard Anderson	President	\$ 1,800
Donald Peterson	Vice President	0
Dawn Johnson	Secretary / Treasurer	23,930

The company has no group health insurance. However, the Secretary/Treasurer is reimbursed by the company for monthly health insurance coverage of her own choice, which currently amounts to \$346.

Agents Richard Anderson and John Haroldson also receive a monthly allowance for health insurance coverage of their own choice, which currently amounts to \$250 for each agent. The above health insurance payments are approved by the board of directors.

The board of directors has also approved Secretary/Treasurer reimbursement of \$3,120 annually for personal residence space used by the company for its office headquarters.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors.

The committees at the time of the examination are listed below:

Adjusting Committee	Finance Committee	Business Plan Committee
James Isherwood, Chair	Donald Peterson, Chair	Richard Anderson, Chair
Donald Peterson	James Isherwood	Donald Peterson
John Haroldson	John Haroldson	James Isherwood
Alyce Kolden	Alyce Kolden	John Haroldson
Dawn Johnson	Dawn Johnson	Alyce Kolden
		Dawn Johnson

Growth of Company

The growth of the company during the past five years as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Net Losses and LAE Incurred	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
1997	\$ 96,754	\$177,592	1,242	\$(183,034)	\$689,370	\$485,174
1998	218,839	247,333	1,210	(129,150)	643,801	387,553
1999	224,342	142,564	1,188	(28,057)	587,832	360,630
2000	244,501	118,267	1,154	13,747	622,348	401,677
2001	255,689	200,331	1,125	(68,274)	551,491	324,567

The ratios of premiums written, gross and net, to surplus as regards policyholders during the past five years were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios Gross	Net
1997	\$412,156	\$181,298	\$485,174	85%	37%
1998	488,730	236,267	387,553	126	61
1999	492,808	213,729	360,630	137	59
2000	486,216	236,136	401,677	121	59
2001	487,244	266,982	324,567	150	82

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Composite Ratio
1997	\$177,592	\$128,647	\$ 96,754	184%	71%	255%
1998	247,333	123,142	218,839	113	52	165
1999	142,564	125,716	224,342	64	59	122
2000	118,267	128,015	244,501	48	54	103
2001	200,331	131,329	255,689	78	49	128

The company has experienced a pattern of net underwriting losses, net operating losses and decreasing surplus trends over the five year period since the last examination, due in part to windstorm related claims and losses. Surplus declined from \$675,874 in 1996 to \$324,567 in 2001 – a decrease of 52%. The significant decrease in earned premiums in 1997 is attributed to the company's conversion from a 3-year term policy with annual post-assessments in 1996 to a 1 year term prepaid policy in 1997 with no assessments during the 1997 transition period. The company waived collection of about \$120,000 of post-assessment premiums in 1997 at the transition, which contributed to the loss in surplus during this period. Because net written and net earned premiums were much lower in 1997, the

loss ratio and underwriting expense ratio were unusually high because they are computed as a percentage of the net earned and net written premiums, respectively.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2002
Termination provisions:	90 days advance written notice by either party, effective on contract anniversary dates

The coverages provided under this treaty are summarized as follows:

1. Type of contract: Class A Excess of Loss

Lines reinsured: All business written classified as casualty business

Company's retention: \$500 each and every loss occurrence

Coverage: 100% of each loss and loss adjusting expense in excess of the company's retention, subject to maximum policy limits of:
 - a. \$1,000,000 per occurrence, single limit, combined for bodily injury and property damage liability
 - b. \$1,000,000 split limits, in any combination of bodily injury and property damage liability
 - c. \$ 5,000 medical payments per person; \$25,000 per accident
Reinsurance premium: 75% of the company's gross premium written
2. Type of contract: Class B First Surplus

Lines reinsured: All property business written by the company

Coverage and limits: The company may automatically cede on a pro rata basis up to \$800,000 on a risk when the company's net retention is \$300,000; when the retention is less than \$300,000 it may cede on a pro rata basis up to 50%.

As a method of stabilizing the loss ratio, the company shall retain, as an Annual Aggregate Deductible, an amount equal to 10% of the loss and loss adjusting expenses otherwise recoverable. This deductible shall be waived when the ultimate net loss exceeds the combination of the Excess of Loss Retention and any Excess of Loss Annual Aggregate Deductible specified in C-1 First Layer Excess of Loss.

Reinsurance premium: 100% of unearned premium applicable to the business covered

Ceding commission: A sliding scale commission includes a minimum 15% provisional commission when the loss ratio is 65% or greater. This minimum commission is increased 1% for each 1% decrease in the loss ratio, subject to a maximum commission of 35% when the loss ratio is 45% or less.

3. Type of contract: Class C Excess of Loss First Layer

Lines reinsured: All property business written by the company

Company's retention: \$25,000 each and every risk from one loss occurrence. In addition, the company retains as an Annual Aggregate Deductible, an amount equal to \$25,000 of loss that would otherwise be recoverable for the annual contract period.

Coverage: 100% of any loss, including loss adjusting expense, above the company's retention, subject to the reinsurer's limit of liability of \$75,000

Reinsurance premium: Premium is calculated by applying a formula that is based on the ratio of the sum of the four years' losses incurred to the company's net premium written for the same period multiplied by a factor of 100/80ths. Premium is subject to a minimum rate of 6%, a maximum rate of 22%, and a current year rate of 8.29%. Deposit premiums are payable in equal monthly installments subject to a minimum annual premium of \$20,160.
4. Type of contract: Class C Excess of Loss Second Layer

Lines reinsured: All property business written by the company

Company's retention: \$100,000 in respect to each and every risk resulting from one loss occurrence

Coverage: 100% of any loss, including loss adjusting expense, in excess of \$100,000 subject to the reinsurer's limit of liability of \$200,000

Reinsurance premium: 3% of subject net premiums written subject to a minimum premium of \$7,200 paid in equal monthly installments
5. Type of contract: Class D/E Stop Loss

Lines reinsured: All business written by the company

Company's retention: Annual aggregate net losses up to 75% of the company's net premium written, subject to a minimum retention of \$198,000

Coverage: 100% of the company's aggregate losses, including loss adjusting expense, which exceeds 75% of net premium written

Reinsurance premium: Premium is calculated by applying a formula that is based on the ratio of the sum of eight years' losses incurred to the company's net premiums written for the same period multiplied by a factor of 100/80ths. Premium is subject to a specified minimum rate of 7%, a maximum rate of 25%, and a current year rate of 7%. Deposit premiums are payable in equal monthly installments subject to a minimum annual premium of \$18,240.

The company acquires facultative reinsurance for policies with coverage over \$1,100,000, directly from Wisconsin Reinsurance Corporation for individual policies requiring the coverage.

III. FINANCIAL DATA

The following financial statements were filed with the Commissioner of Insurance in the company's annual statement at December 31, 2001. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

**New Hope Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2001**

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash in Company's Office	\$ 200	\$	\$	\$ 200
Cash Deposited in Checking Account	40,030			40,030
Cash Deposited at Interest	131,417			131,417
Bonds (at Amortized Cost)	95,516			95,516
Stocks or Mutual Fund Investments (at Market)	258,009			258,009
Premiums and Agents' Balances In Course of Collection	1,053			1,053
Investment Income Due or Accrued		2,322		2,322
Electronic Data Processing Equipment – Excluding Software (Cost Less Accumulated Depreciation)	817			817
Reinsurance Premium Recoverable	7,140			7,140
Other Assets: Reinsurance Commission Recoverable	14,987			14,987
Prepaid Insurance	1,309		1,309	
Furniture and Fixtures	<u>93</u>	<u> </u>	<u>93</u>	<u> </u>
TOTALS	<u>\$ 550,571</u>	<u>\$ 2,322</u>	<u>\$1,402</u>	<u>\$ 551,491</u>

New Hope Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2001

Liabilities and Surplus

Net Unpaid Losses	\$ 16,901
Unpaid Loss Adjustment Expenses	289
Commissions Payable	4,633
Fire Department Dues Payable	141
Unearned Premiums	174,715
Amounts Withheld for the Account of Others	620
Payroll Taxes Payable	305
Other Liabilities:	
Expense Related	
Accrued Property Taxes	26
Nonexpense Related	
Premiums Received in Advance	<u>29,294</u>
TOTAL LIABILITIES	226,924
Policyholders' Surplus	<u>324,567</u>
TOTAL	<u>\$ 551,491</u>

New Hope Mutual Insurance Company
Statement of Operations
For the Year 2001

Net Premiums and Assessments Earned	<u>\$ 255,689</u>
Deduct:	
Net Losses Incurred	184,684
Net Loss Adjustment Expenses Incurred	15,647
Other Underwriting Expenses Incurred	<u>131,329</u>
Total Losses and Expenses Incurred	<u>331,660</u>
Net Underwriting Gain (Loss)	<u>(75,971)</u>
Net Investment Income:	
Net Investment Income Earned	6,882
Net Realized Capital Gains	<u>0</u>
Total Investment Income	<u>6,882</u>
Other Income:	
Miscellaneous Income	815
Total Other Income	<u>815</u>
Net Income (Loss) Before Policyholder Dividends and Before Federal Income Taxes	(68,274)
Policyholder Refunds or Dividends	<u>0</u>
Net Income (Loss) Before Federal Income Taxes	(68,274)
Federal Income Taxes Incurred	<u>0</u>
Net Income (Loss)	<u><u>\$ (68,274)</u></u>

New Hope Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the 5-Year Period Ending December 31, 2001

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	1997	1998	1999	2000	2001
Surplus, beginning of year	\$675,874	\$485,174	\$387,553	\$360,630	\$401,677
Net income	(183,034)	(129,150)	(28,057)	13,747	(68,274)
Net unrealized capital gains or (losses)	(8,458)	30,546	811	27,136	(9,016)
Change in non-admitted assets	793	986	321	161	182
Other gains and (losses) in surplus:					
Rounding	(1)	(3)	2	3	(2)
Surplus, end of year	<u>\$485,174</u>	<u>\$387,553</u>	<u>\$360,630</u>	<u>\$401,677</u>	<u>\$324,567</u>

Reconciliation of Policyholders' Surplus

A reconciliation of the policyholders' surplus as reported by the company in its filed annual statement and as determined by the examination is detailed in the following schedule:

Policyholders' Surplus per December 31, 2001, Annual Statement			\$ 324,567
Item	Increase	Decrease	
Case Loss Reserve Deficiencies	\$	\$ (6,149)	
IBNR Loss Reserve Deficiencies	_____	<u>(8,379)</u>	
Total	<u>\$</u>	<u>\$ (14,528)</u>	
Decrease to Surplus per Examination			<u>(14,528)</u>
Policyholders' Surplus per Examination			<u>\$ 310,039</u>

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. EDP Environment—It is recommended that the company retain its year-end back-up data for all years since the last OCI examination, pursuant to s. Ins. 6.80 Wis. Adm. Code.

Action—Compliance

2. Disaster Recovery Plan—It is recommended that the company develop a disaster recovery plan.

Action—Compliance

3. Invested Assets—It is recommended that the company comply with s. 610.23 Wis. Stat. and s. Ins. 13.05 Wis. Adm. Code, as regards custody and control of its invested assets.

Action—Compliance

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent current period. Board of directors and committee meeting minutes did not always include identification and approval of major transactions. Specifically, it is recommended that board of directors and finance committee minutes be expanded to more completely demonstrate company activity oversight by:

- Identification and approval of major expenses such as officer salary
- Identification of directors who abstained from voting due to potential conflicts of interest among existing officers / directors who also serve as company agents / adjusters
- Identification and approval of specific investment transaction purchases and sales

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts do not include language indicating the agent will represent the company's interests "in good faith." The agency agreements also include various attached amendments since their original execution in 1983.

Compliance with amendments relating to agency Errors & Omissions coverage requirements of \$1,000,000 was not evidenced as of 12/31/01 for the Anderson Agency. Accordingly, it is recommended that agency agreements be reviewed and updated to:

- Incorporate language related to agent responsibility to represent the company's interests "in good faith"
- Incorporate various agreement amendment updates since the original execution.

In addition, it is recommended that the company develop procedures to ensure that its agents comply with contract terms, including maintenance of agreed-upon E&O coverage requirements.

Management and Control

The 5-year financial history period since the prior examination indicates a pattern characterized by underwriting losses, net operating losses and decreasing surplus trends, as previously noted. In particular, surplus has decreased from \$675,874 in 1996 to \$324,567. Company business and financial plans are relatively general in nature. Accordingly, it is recommended that the board evaluate its longer term objectives and establish more definitive business plans and financial targets to measure performance improvement in underwriting income, net income and surplus growth, which have experienced weak financial trends over the past 5-year historical period.

These business plans should conceivably include consideration of the potential for:

- Expense reduction in higher cost areas, such as commissions and agent benefits, where total direct commissions were over \$85,000 in 2001
- Rate tracking, industry comparisons, evaluation and adjustment in applicable areas, such as Farm Fire & EC and Non-Farm rates, which the Company indicates have not been adjusted since 1998 and 1974, respectively
- Current / prior year loss ratio experience tracking by type of business and by agent
- CD investment portfolio search for best rates to maximize other income

As discussed earlier in this report, the company's practice is to pay the "new business" commission rate of 25% when a renewal policy contains a signed application. The signed application is presumed to indicate that the agent performed a reinspection of the property. The decision to contact a policyholder for a signed application and reinspection is at the agent's discretion. There is very little actual new business written by the company. In 2001, the company paid \$85,000 in direct commissions, which is about 17.5% of direct premiums. This indicates that agents were paid the 25% commission on about 25% of the company's premium volume.

It is very unusual for a company to pay a "new business" commission rate for performing a reinspection at the agent's discretion. In most companies, the manager (rather than the agent) determines the reinspections to be performed each month. The reinspection is paid for either as part of an employee's salary or at a reasonable hourly rate plus mileage, not with an additional 10% commission. It is recommended that the company: (1) reevaluate its practice of paying the "new business" commission rate of 25% for renewals with signed applications, (2) establish a procedure where the manager determines which reinspections are to be performed each month, and (3) not pay for reinspections on a commission basis.

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with apparent conflicts being noted. Specifically, the dual roles served by R. Anderson (President/Director) and J. Haroldson (Director) as the company's primary agents and internal adjusters was noted.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity Bond	\$ 50,000
Professional Liability and Directors & Officers Liability	\$1 million each claim \$1 million aggregate per policy period
Property & Liability	Business Personal Property = \$10,000 Money & Securities On-Premise = \$10,000 Money & Securities Off- Premise = \$5,000 Liability & Medical Expenses = \$1,000,000 Fire Damage = \$100,000
Workers Compensation	Medical and Indemnity = statutory Bodily Injury By Accident = \$100,000 Each Accident Bodily Injury By Disease = \$100,000 Each Employee \$500,000 Policy Limit

Underwriting

The company has a written property underwriting guide. The guide covers all the lines of business that the company is presently writing. The Company utilizes general WRC guidelines for its liability insurance business.

The company does not have a formal inspection procedure for both new and renewal business, based on reliance on the existing roles of officer / director R. Anderson and director J. Haroldson, who serve as the company's primary agents and adjusters. The board has discussed the potential to utilize an outside adjuster for irrigation related claims, but has not acted. Accordingly, it is recommended that the company establish procedures to utilize an external adjuster / inspector, particularly in higher risk business lines such as irrigation systems, to strengthen control over claims and minimize potential conflicts of interest through review by parties independent of the risk under consideration.

The company does not have standard checklists for performing inspections of farms, homes and mobile homes. Use of standard checklists would ensure consistency and provide documentation of the inspections performed. It is recommended that the company obtain or develop checklists for performing inspections.

The company does not have a standard process to determine the insured value of the buildings, such as the use of a building valuation manual. It is recommended that the company establish a standard process for determining the insured value of buildings such as the use of a building valuation manual, establish a plan for agent training and prioritize a schedule for review of building values.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to supervise the adjustment of losses. Accordingly, it is recommended that the company formally establish maximum adjustor authority limits to ensure adjusting committee review and approval of larger claims prior to payment.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2001.

The company is audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's Electronic Data Processing environment. Access to the computer is limited to people authorized to use the computer.

Company personnel back up the computers daily / monthly and the backed-up data is kept in on-site fireproof vault facilities. Weekly back-ups are also performed for off-site backup purposes.

A WRC Systems manual describes how to use the company's software and outlines the steps to complete specific tasks, assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company does not have manuals documenting the use of its software.

It is suggested that the development of company specific documentation relating to major processing routines and procedures be considered to supplement back-up plans and provide for future training.

Electronic Data Processing procedure review indicated virus software was installed. However, during the course of the examination fieldwork, virus software had to be reinstalled due to apparent contract termination. It is recommended that virus software be maintained and provision for periodic update be reviewed with the software vendor to ensure the most current security protection.

Disaster Recovery Plan

A disaster recovery plan identifies steps to be performed in case the company loses a key employee, is not able to access its computer, information on its computer was lost, or the office building was destroyed, to name a few contingencies. The company has developed a disaster recovery plan. The company's disaster recovery plan appears to be reasonably adequate in relation to the company's size.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

- (1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and
- (2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements. The Company has negotiated a new custodial agreement with its custodial bank since the prior examination, which contains appropriate language with respect to indemnification in the event of loss of securities. It is recommended that the company update its custodial agreement to reflect the current company name change to New Hope Mutual Insurance Company.

Investment Rule Compliance

The investment rule for town mutuals allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1. Liabilities plus \$300,000	\$526,924
2. Liabilities plus 33% of gross premiums written	\$389,339
3. Liabilities plus 50% of net premiums written	\$360,415
4. Amount required (greater of 1, 2, or 3)	\$526,924
5. Amount of Type 1 investments as of 12/31/2001	<u>\$266,963</u>
6. Excess or (deficiency)	<u>(\$259,961)</u>

The company does not have sufficient Type 1 investments.

The company has received approval to exceed the 25% guideline limit for aggregate investments in common stocks, preferred stocks and mutual funds that invest in stocks. The amount approved is 45%. The company has one bond holding (HHFC) which represents 4% of admitted assets. The company has also received approval to hold this investment, which exceeds the 3% of asset limits, until maturity.

Type 2 investments consist only of Wisconsin reinsurance and NAMICO stock holdings, which received prior approval. The company may make no additional Type 2 investments until the company meets the required amount of Type 1 investments, pursuant to s. Ins 6.20 (6) (c), Wis. Adm. Code.

ASSETS

Cash and Invested Cash

\$171,647

The above asset is comprised of the following types of cash items:

Cash in company's office	\$ 200
Cash deposited in banks-checking accounts	40,030
Cash deposited in banks at interest	<u>131,417</u>
Total	<u>\$ 171,647</u>

Cash in the company's office at year-end represents the company's petty cash fund. A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in one bank. Verification of the checking account balance was made by obtaining the company's CPA confirmation directly from the depository and reconciling the amount shown thereon to company records.

Cash deposited in banks represents the aggregate of eleven deposits in five depositories. Deposits were verified by obtaining the company's CPA confirmations with the respective depositories along with the CPA's actual count and inspection of certificates and/or passbooks. These investments are held under bank safe deposit safekeeping at a local bank or under custodial safekeeping at the custodial bank. Interest received during the year 2001 totaled \$8,375 and was verified to company cash records. Rates of interest earned on cash deposits ranged from .55% to 5.4%. Accrued interest on cash deposits totaled \$898 at year-end.

Book Value of Bonds

\$95,516

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2001. Bonds owned by the company are held by the custodial bank under a custodial safekeeping agreement.

Bonds were verified by obtaining the company's CPA confirmations and broker statements. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Interest received during 2001 on bonds amounted to \$6,651 and was traced to cash receipts records. Accrued interest of \$1,424 at December 31, 2001, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments

\$258,009

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2001. Stocks owned by the company are located in the company's safe deposit box at a local bank.

Stock certificates were verified by obtaining the company's CPA workpapers evidencing physical examination. There were no stock or mutual fund purchases and sales for the period under examination. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

The company received no dividends during 2001 on stocks. There were no accrued dividends as of December 31, 2001.

Agents' Balances or Uncollected Premiums

\$1,053

The above ledger asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. A review of individual agent's accounts and subsequent payments verified the accuracy of this asset.

Investment Income Due and Accrued

\$2,322

Interest due and accrued on the various assets of the company at December 31, 2001, consists of the following:

Cash on Deposit	898
Bonds	<u>1,424</u>
Total	<u>\$ 2,322</u>

Accrued interest was verified by recalculation and tracing to income receipt on a sample basis.

Electronic Data Processing Equipment

\$817

This asset represents the value of computer equipment including the operating system software less depreciation as of December 31, 2001. Non-operating system software is not included in the value. The balance was verified by recalculation of depreciation under the company's methodology.

Reinsurance Premiums Recoverable**\$7,140**

The above asset represents recoveries due to the company at December 31, 2001, relating to net reinsurance overpayments which occurred on or prior to that date. A review of year-end accountings with the reinsurer and subsequent settlement verified the above asset. The recoverable consisted of the following classes of reinsurance coverage and corresponding balances:

Class A Liability	\$ 9,340
Class C-1 First Excess of Loss	(1,200)
Class C-2 Second Excess of Loss	(400)
Class D/E Stop Loss	<u>\$ (600)</u>
Total	<u>\$ 7,140</u>

The company's recently updated Reinsurance Contract with WRC incorrectly refers to the company name as New Hope Mutual Fire Insurance and excluded Class C-1 coverage of LAE. It is suggested that the company follow-up with WRC to correct the company's recently updated reinsurance contract for the correct company name and C-1 coverage inclusion of LAE.

Reinsurance Contingent Commissions Recoverable**\$14,987**

The above asset represents the commission that is recoverable from the reinsurer under the 15% sliding scale provisions of Class B First Surplus. The balance was verified by tracing to applicable WRC reinsurance accounting reports and subsequent funds settlement.

Prepaid Insurance**\$1,309**

This asset represents insurance premiums paid in advance on policies the company has for its own protection as of December 31, 2001. This amount has been deducted as a non-admitted asset in accordance with annual statement requirements. Prepaid balances were verified by tracing to applicable insurance policy billings.

Equipment, Furniture, and Supplies**\$93**

This asset consists of \$93 of equipment and supplies owned by the company at December 31, 2001. In accordance with annual statement requirements, this amount has been deducted as an asset not admitted.

LIABILITIES AND SURPLUS

Net Unpaid Losses

\$16,901

This liability represents losses incurred on or prior to December 31, 2001, and remaining unpaid as of that date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule. Differences are reflected in the section of this report captioned "Reconciliation of Policyholders' Surplus."

	Company Estimate	Examiners' Development	Difference
Incurred But Unpaid Losses	\$ 34,550	\$ 96,525	\$ 61,975
Less:			
Reinsurance Recoverable on Unpaid Losses	<u>17,649</u>	<u>65,096</u>	<u>47,447</u>
Net Unpaid Losses	<u>\$ 16,901</u>	<u>\$ 31,429</u>	<u>\$ (14,528)</u>

The examiners developed this liability by totaling actual loss payments made through the development period on those losses incurred on or prior to December 31, 2001. To the actual paid loss figures was added an estimated amount for those 2001 and prior losses remaining unpaid at the examination date. The above reserve deficiency difference of (\$14,528) was considered material for purposes of this examination.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files generally contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

Review of year to date claims paid indicated payment for a number of 2001 insured reported claims which were apparently not reported by the agent until 2002, contributing to the reserve deficiencies noted above. Accordingly, it is recommended that company establish procedures to provide for more timely agent claims filing to ensure company awareness, proper recording of reserve provisions and to permit proper supervision of claims by the adjusting committee. Review of the company's "Schedule of Loss Adjusting Form" may facilitate this process.

Unpaid Loss Adjustment Expenses**\$289**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2001, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is based on the review of the development of losses on 2001 and prior claims paid by the company.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined that potential additional liability could exist based on the amount of estimated reserve deficiency identified above under Unpaid Losses. However, such amounts would not likely exceed materiality.

Commissions Payable**\$4,633**

This liability represents the commissions due and payable to company agents as of December 31, 2001. Supporting commission registers and subsequent cash disbursement records were reviewed to verify the above amount.

Fire Department Dues Payable**\$141**

This liability represents the fire department dues payable at December 31, 2001. The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was also verified to this office's premium tax system payment history records.

Unearned Premiums**\$174,715**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology. Unearned Premium balances were verified based on recalculation utilizing audit software and validation of a sample of supporting in-force premiums to policyholder files.

Amounts Withheld for the Account of Others**\$620**

This liability represents employee payroll deductions in the possession of the company at December 31, 2001. Company supporting records and subsequent cash disbursements verified this item.

Payroll Taxes Payable**\$305**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2001, which had not yet been paid. Supporting company records and subsequent payroll cash disbursements verified this item.

Accrued Property Taxes**\$26**

This liability represents the personal property taxes accrued as of December 31, 2001. The balance was verified by tracing to the applicable property tax billing.

Premiums Received in Advance**\$29,294**

This amount represents the liability for premiums received by the company in 2001 for policy effective dates in 2002. These advance premiums were validated by tracing selected premiums to applicable cash receipt records. Reconciling differences of approximately \$4,000 were determined to be reasonable due to advance premiums received prior to December 2001, which had already been closed in conjunction with prior month-end processing.

Other Liabilities – Accounts Payable**\$0**

This liability typically represents anticipated expense items payable by the company for services as of December 31, 2001, which will not be billed or paid until the subsequent year. Review of cash disbursements in 2002 indicated payment of expenses in the amount of \$10,621 related to external CPA services rendered relative to the annual examination of financial records for calendar year 2001, which was performed from March 16, 2001 to February 28, 2002. It is recommended that year-end accounting provisions more appropriately recognize an accrual for major expenses such as CPA audit fees.

V. CONCLUSION

New Hope Mutual Insurance Company reported admitted assets of \$551,491, liabilities of \$226,924 and surplus of \$324,567 as of the current examination. Examination adjustments reduced reported surplus to \$310,039. From an overall solvency perspective, the company has continued to experience a decrease in surplus during the period since the prior 1996 examination of approximately 52% from \$675,874 to \$324,567. An underwriting loss has been experienced each year with a net operating loss being reported 4 of the last 5 years. Also, in 2002 the company must record an unrealized loss of about \$30,000 on the value of its common stock investment in its reinsurer. The minimum required surplus for town mutual insurers is \$200,000, so the company is approaching the legal requirement.

The above financial trends have been reflective of various loss claim experience due to windstorm damage related to a very specialized insurance business line associated with irrigation systems.

Examination review indicated that the company was in compliance with prior examination recommendations.

The current examination made thirteen recommendations and two suggestions. The major recommendations relate to:

- Business plan development to address improvements in the above financial trends.
- Claim reporting procedure development to provide more timely agent reporting of claims and ensure timely recording of estimated reserve positions. Lack of timely agent claim reporting resulted in current examination report Surplus adjustments to recognize Case and IBNR Reserve deficiencies of approximately \$14,500.

Overall, the current examination recommends that company management and the board of directors build on its very general business and financial plans to establish more definitive financial performance targets and measurement criteria to achieve and sustain growth, in the best interests of all policyholders.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 14 - Corporate Records—It is recommended that board of directors and finance committee minutes be expanded to more completely demonstrate company activity oversight by:
 - Identification and approval of major expenses such as officer salary
 - Identification of directors who abstained from voting due to potential conflicts of interest among existing officers / directors who also serve as company agents and adjusters
 - Identification and approval of specific investment transaction purchases and sales
2. Page 14 - Corporate Records—It is recommended that agency agreements be reviewed and updated to:
 - Incorporate language related to agent responsibility to represent the company's interests "in good faith"
 - Incorporate various agreement amendment updates since the original execution
3. Page 14 - Corporate Records—It is recommended that the company develop procedures to ensure that its agents comply with contract terms, including maintenance of agreed-upon E&O coverage requirements.
4. Page 14 - Management and Control—It is recommended that the board evaluate its longer term objectives and establish more definitive business plans and financial targets to measure performance improvement in underwriting income, net income and surplus growth, which have experienced weak financial trends over the past 5-year historical period.
5. Page 15 - Management and Control—It is recommended that the company: (1) reevaluate its practice of paying the "new business" commission rate of 25% for renewals with signed applications, (2) establish a procedure where the manager determines which reinspections are to be performed each month, and (3) not pay for reinspections on a commission basis.
6. Page 16 - Underwriting—It is recommended that the company establish procedures to utilize an external adjuster / inspector, particularly in higher risk business lines such as irrigation systems, to strengthen control over claims and minimize potential conflicts of interest through review by parties independent of the risk under consideration.
7. Page 16 - Underwriting—It is recommended that the company obtain or develop checklists for performing inspections.
8. Page 17 - Underwriting—It is recommended that the company establish a standard process for determining the insured value of buildings, such as the use of a building valuation manual, establish a plan for agent training and prioritize a schedule for review of building values.
9. Page 17 - Claims Adjusting—It is recommended that the company formally establish maximum adjuster authority limits to ensure adjusting committee review and approval of larger claims prior to payment.
10. Page 18 - EDP Environment—It is suggested that the development of company specific documentation relating to major processing routines and procedures be considered to supplement back-up plans and provide for future training.
11. Page 18 - EDP Environment—It is recommended that virus software be maintained and provision for periodic update be reviewed with the software vendor to ensure the most current security protection.

12. Page 18 - Invested Assets—It is recommended that the company update its custodial agreement to reflect the current company name change to New Hope Mutual Insurance Company.
13. Page 22 - Reinsurance Premiums Recoverable—It is suggested that the company follow-up with WRC to correct its recently updated reinsurance contract for the current company name and Class C-1 coverage inclusion of LAE.
14. Page 23 - Net Unpaid Losses—It is recommended that the company establish procedures to provide for more timely agent claims filing to ensure company awareness, proper recording of reserve provisions and to permit proper supervision of claims by the adjusting committee.
15. Page 25 - Other Liabilities – Accounts Payable—It is recommended that year-end accounting provisions be established to more appropriately recognize an accrual for major expenses such as CPA audit fees.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Rebecca Easland of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Respectfully submitted,

Tom M. Janke
Examiner-in-Charge